

FISCAL SETTLEMENTS OF INCOMES OBTAINED FROM ABROAD BY NATURAL PERSONS RESIDENT IN ROMANIA

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The resident natural persons and those who qualify for residency conditions are subject to taxation in Romania for the incomes from any source, both from Romania and from abroad. External fiscal credit can be granted in order to avoid double taxation, so that the person can be entitled to deduct from the tax on income due in Romania the tax of income paid abroad, without exceeding the share of the income tax payable in Romania related to the income from abroad. The procedure of granting external fiscal credit vary depending on different categories of income.

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The income obtained from abroad by natural persons resident in Romania are taxed under the national legislation, corroborated with the provisions of conventions for avoidance of double taxation concluded between Romania and other countries. The conventions for avoidance of double taxation determine which state has the right to tax incomes of natural persons, respectively the residence state or income source state.

In order to benefit from the provisions of conventions for avoidance of double taxation the Romanian natural persons will obtain from the Romanian fiscal authority the certificate of fiscal residence (according to OMF no. 1798/1998 for approval of forms regarding the application of conventions for avoidance of double taxation and determining the powers of signing this form) which he will present to the fiscal authorities from the income source country. The certificate of fiscal residence can also be obtained by natural persons who qualify for residency conditions for three consecutive years, starting from the fourth fiscal year.

The tax on incomes obtained from abroad is owed by:

- resident natural Romanian persons that are domiciled in Romania;
- natural persons that fulfill the criteria for residence for 3 years in a row become subject on income tax starting the fourth fiscal year.

Establishment of the residence in Romania for natural persons, according to Romanian legislation

In the Romanian legislation, the notion of resident involves every natural resident person and every Romanian legal person. According to the Fiscal code a resident natural person is “any individual who meets at least one of the following conditions³¹⁹:

- a) the person has his or her domicile in Romania;
- b) the center of vital interests of the person is located in Romania;

³¹⁹ Law no 571/2003 regarding the Fiscal Code, with the changes and ulterior completions, Official Monitor no 927/23.12.2003.

c) the person is present in Romania for a period or periods that exceed in total 183 days during any period of 12 consecutive months ending in the calendar year in question;

d) the person is a Romanian citizen who is serving abroad as an official or employee of Romania in a foreign state.

In order to prove that the natural person has its center of vital interests located abroad, it has to present the necessary documents to the tax office to prove that incomes obtained from abroad are higher than incomes obtained from Romania and that the tax authority of the relevant State is exercising its right to consider that person as its resident on globalized income taxation and in this case the person is subject to taxation in Romania only for incomes obtained in Romania

The following persons are exempt:

- a foreign citizen with diplomatic or consular status in Romania;

a foreign citizen who is an official or employee of an international and intergovernmental organization that is accredited in Romania;

- a foreign citizen who is an official or employee of a foreign state in Romania and members of the family of such foreign citizens.

The concept of resident through The Model Convention OCDE for avoidance of double taxation

According to the Model Convention OCDE the term of “resident of a Contracting Country” represents every person that, in accordance with the country legislation, he is obliged to pay taxes in that Country, for reasons of domicile, residence, management place and any other criteria of similar nature, but excluding the persons that are subject to taxes in that country only for the income obtained from sources in that Country or for the stock situated in that Country.

In the case where the person is resident of both the Contracting Countries, there were set up the following criteria of establishing the residence, applied in the following order:

1) the person will be considered a resident of the Country that has a permanent domicile, put on her disposal; if she holds a permanent apartment in both the Countries, she will be considered resident only in the Country where her personal and economical relations are tight (the centre of vital interests). For solutioning the possible conflicts that might appear between the laws of the two countries, the first criteria which will be taken into consideration is the holding of every form of set up domicile for permanent use of the person concerned, that means that it is not taken into account a domicile that is used occasionally, or for short period. If the person has a permanent domicile in both the Contracting Countries, it is required to analyze the situation in order to decide with which of the two Countries the person concerned has closer personal and economical relationships, that means that they will be taken into account others criteria: family, her social relations, occupations, her political activities, cultural or of any other type, her place of activity, the place where she administers her properties, etc.

2) If the Country where the individual has the centre of vital interests can't be determined, or if the person concerned does not hold a permanent domicile put on her disposal in neither of the states, it will be considered that she is a resident of the Country where she has the usual address;

3) If the person has the usual address in both Countries or in none of them, it will be considered that she is resident of the country where she has the usual address.

4) If the person has the nationality of both Countries or in none of them, the competent authorities of the Contracting Countries will solve this matter amicably.

So, if the first criterion cannot apply for establishing the residence, it is applied the second one, it is repeated this algorithm until the last criterion, respectively the amicable procedure stipulated in Article 25 from the Model Convention.

Tax on incomes obtained from abroad owed in Romania by natural persons

A natural person can be subject to income tax in Romania for both local and abroad incomes if the one of the following conditions is met for three year in a row:

- the center of vital interests of the person is located in Romania;
- the person is present in Romania for a period or periods that exceed in total 183 days during any period of 12 consecutive months ending in the calendar year in question;

Documents required for establishing the center of vital interests are: copies of income declarations from the foreign state, statement concerning the situation of school children, the statement of assets, where appropriate, for members of family and other documents.

In case the incomes from the foreign state are below requirements and therefore tax residence cannot be granted, the Romanian authorities find that conditions are met in order to tax the incomes in Romania and do so, by taxing the globalised income of that natural person. Romanian authorities and authorities from the foreign state will exchange information concerning the case.

Where income from other state are not conducive to the granting of tax residence in this state and Romanian tax authority considers that the conditions for taxation in Romania, the taxpayer will be required in Romania and worldwide revenue by information exchange, Romanian authorities and other State shall inform about this case.

Starting the 4th year of compliance of one of the above conditions, the natural person is to become a fiscal resident and therefore subject to taxation in Romania for all incomes. Tax authority will issue a fiscal residence certificate also in the 4th year.

Taxpayers that live abroad and keep their domicile in Romania are subject to taxation in Romania, according to Romanian legislation, for taxable incomes obtained both in Romania and from abroad. In case they cannot fulfill its obligation they can empower a natural person or designate fiscal representative

In order to tax incomes from abroad the taxation rate (16%) is applied to the basic income determined by specific rules for each category: independent activities, commerce activities, intellectual property rights, the grant of the use of goods, dividends, interests, prizes and gambling, transfer of securities, other investments and sources of incomes from abroad.

Losses from abroad are carried over and compensates incomes of the same category or nature of incomes obtained from abroad, for each foreign country for the next 5 fiscal years.

The taxpayers that obtained incomes from abroad have to fill in form 201 “Special Declaration regarding the incomes earned abroad” and submit it to the tax office by may 15th of the year following the year they obtained the income. The sources of incomes included in form 201 “Special Declaration regarding the incomes earned abroad” are: independent activities, commerce activities, intellectual property rights, the grant of the use of goods, dividends, interests, prizes and gambling, transfer of securities, other investments and sources of incomes from abroad.

The forms regarding the incomes earned abroad have to be submitted for each foreign state and for each source of income by may 15th of the year following the year the income was obtained.

For incomes earned abroad in 2010 the taxpayers have to submit the *tax statements* by may 25th of the year following the year the income was obtained and also they have to determine the tax amount³²⁰.

External fiscal credit

The method used in Romania to avoid double taxation as it is provided by the OECD model of the Convention for avoidance of double taxation, is the credit method, by granting external fiscal

³²⁰ The Emergency Government Ordinance no. 109/07.10.2009, for the amendment and supplementation of Law no. 571/2003 regarding the Fiscal Code, published in the Official Monitor no. 689/13.10.2009.

credit for incomes obtained from abroad, which are subject to taxation in both states. By this method the tax due in the foreign state is to be deducted from the tax paid in the state of residence, under certain conditions

Credit method in terms of the OECD model of the Convention for avoidance of double taxation

The credit method takes into account the so-called legal double taxation, that means the case where the same capital or the same income is taxable in several States. In the conventions for avoidance of double taxation there is a difference between the income tax and the capital tax, there are several ways of eliminating double taxation: exemption method (complete or gradual) and the credit method (full or ordinary). By the ordinary credit method it is given the deduction from the tax owned in the residence state of an amount equal to the tax paid in the source state, but without exceeding the income tax or the capital tax calculated before the deduction is given, which is attributable, depending on the case, to the income or capital which can be taxed in the source state.

Granting the external fiscal credit according to national legislation

Resident natural persons taxpayers, who, for the same income over the same taxable period and are subject to tax income both in Romania and abroad, are entitled to the deduction of income tax due in Romania of the tax paid abroad. The amount deducted from income tax in Romania is called external fiscal credit. Having at the basis the principle of ordinary credit the national legislation provides granting external fiscal credit at the level of the tax paid abroad in association with the income from foreign source, but not exceeding the income tax due in Romania, in association with taxable income from abroad. If the taxpayer in question receives incomes from abroad from several countries, external fiscal credit allowed to be deducted from tax payable in Romania will be calculated according to the above procedure for each country and each kind of income.

The external fiscal credit is granted for the following income categories:

- a) incomes from independent activities;
- b) incomes from wages;
- c) incomes from the grant of the use of goods;
- d) incomes from investments;
- e) incomes from pensions;
- f) incomes from agricultural activities;
- g) incomes from prizes and from gambling;
- h) incomes from transfer of real estates;
- i) incomes from other sources.

Granting the external fiscal credit is made for income types as those mentioned above, only if the tax paid abroad, for the income earned abroad, was actually paid directly by the natural person or his legal representative or by withholding at the source of the payer's income. To benefit from external fiscal credit, the tax paid abroad must be proved by a document in proof, issued by:

- tax authority of the foreign state in question;
- employer, in the case of income from wages;
- other income payer, for other income categories.

At the end of the tax year concerned, the taxpayer attaches to the tax declaration the documents in proof regarding the income and the tax paid, issued by the tax authorities in the country where the income was obtained, employer or other payer, documents used to calculate the fiscal credit.

The exchange in lei of the income obtained abroad and the associated tax expressed in foreign currency units proper to the State in question, are made at the annual average rate of exchange on the currency market, reported by the National Bank of Romania, from the year the income was

earned. If the currency of that country is not listed on the National Bank, the amounts will be transformed in the following way:

- a) from the currency of the source state in an international currency such as dollars or euros, using the exchange rate from the source country;
- b) from the international currency into lei, using the average annual exchange rate of this one, expressed by the National Bank of Romania, from the year the income in question was earned.

Granting external fiscal credit for incomes from independent activities, incomes from the grant of the use of goods and incomes from agricultural activities

Natural persons that have obtained incomes from abroad and paid tax on income in that foreign state are entitled to deduct from the tax on income due in Romania the tax on income paid abroad for each source of income. The tax paid abroad which is deducted from the tax on income owed in Romania is limited at that share of the tax owed in Romania

For the incomes which have been considered abroad as obtained from the entire world, the external fiscal credit for each of these incomes is limited to the tax on income computed by applying the taxation average quote from abroad to each source of income obtained abroad but not exceeding the taxation quote provided by national legislation related to the relevant income.

The taxation average quote is computed as follows:

$$\text{Taxation average quote} = \frac{\text{tax paid abroad}}{\text{global income obtained from abroad}}$$

The global income obtained from abroad represents all the categories of incomes which, by law of the relevant State, shall be globalized abroad.

For the incomes obtained abroad not globalized in view of their taxation, the external fiscal credit is limited to the tax on income from abroad but not exceeding the tax on income due for a similar income in Romania.

In order to grant the deduction, the amount of the external fiscal credit is compared to the tax paid abroad, taking into account the smaller amount:

- if the amount of the external fiscal credit is greater than the tax paid abroad, the amount of this tax will be recognized as being deductible
- if the amount of the external fiscal credit is less than the tax paid abroad, the amount recognized as being deductible and representing the external fiscal credit will be computed according as above.

The external fiscal is computed by the fiscal body distinctly for each source of incomes. If the incomes from abroad of the taxpayer in question are obtained from several countries, the external fiscal credit allowed to be deducted from the tax due in Romania is to be computed according to the above procedure for each source of income and each country.

Starting 2010 calculation of the external fiscal credit according to the same rules.

Granting external fiscal credit for income from investments, incomes from pension, incomes from prizes and gambling, and incomes from transfer of real estates.

External fiscal credit for these categories of income is granted comparing the foreign tax rate paid abroad to that prescribed by internal legislation for each similar income in Romania, as following:

- a) if the foreign tax rate from abroad is higher than that provided in the internal legislation for a similar income, external fiscal credit is limited to income calculated tax by applying the rate provided in the national legislation;
- b) if the tax rate from abroad is lower than tax rate for a similar income in Romania, the external fiscal credit is calculated at the level of tax paid abroad, and the annual tax remaining to be paid in Romania is calculated as the difference between tax income (which will be calculated by

applying the tax rate prescribed by national legislation) and tax income paid abroad for income earned abroad.

Granting external fiscal credit for income from wages

Even though the national legislation states that in Romania will be taxed the income obtained from employment performed abroad and paid for it by the Romanian employer, they are taxed in Romania, however, for this category of income there was no proceeding for granting the foreign tax credit, the legislature stating only that income from wages which are not taxable in Romania, are not related to the foreign tax credit.

Legislation regarding this category of income has been improved, so that starting with income earned in 2010 the following legal provisions will be taken into consideration:

„If the same income from wages is taxable both in Romania and abroad, the foreign state having the right to tax under the Convention for the avoidance of double taxation concluded by Romania with that state for income earned during the period in which Romania has not the right to tax, the competent fiscal authority will reimburse the tax withheld by the Romanian employer, at the request of Romanian resident”³²¹. It can be inferred from these provisions that the reimbursement of tax held in Romania is conditioned by the existence of a convention for avoidance of double taxation between Romania and the State in which the natural person worked.

Analyzing the conventions for avoidance of the double taxation concluded by Romania with various states, it results that income from employment activities performed in another state, which are paid by a Romanian employer and are not borne by a permanent head office that this one has in the foreign State, are taxable in the foreign State only if the natural person receiving the income is present in the foreign State for a period or periods exceeding on the whole 183 days in any 12 month period starting or ending in the calendar year in question.

Therefore, for tax refund in Romania it is taken into consideration only the situation when between Romania and the State where the person has developed his activity there is a convention for avoidance of the double taxation.

Conclusions

For taxation of income from abroad, it will first be determined whether the beneficiary of income is Romanian resident, according to the criteria for residence under national legislation, in conjunction with the provisions of conventions for avoidance of double taxation. After declaring this income, their taxation will be achieved, taking into consideration the granting of the foreign tax credit, taking into account the nature of income earned abroad and presenting the documents in proof on payment of the tax abroad. In Romania, avoidance of double taxation on income earned abroad by Romanian natural persons is done by ordinary credit method, method which is provided for both the conventions for avoidance of double taxation and in national tax legislation.

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